RECORD AND BRIEFS

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No. 16-784

In the Supreme Court of the United States

MERIT MANAGEMENT GROUP, LP,
Petitioner,

v.

FTI CONSULTING, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF AMICUS CURIAE NATIONAL ASSOCIATION OF BANKRUPTCY TRUSTEES IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE

The National Association of Bankruptcy Trustees ("NABT") is a nonprofit association formed in 1982 to address the needs of chapter 7 bankruptcy trustees throughout the country and to promote the effectiveness of the bankruptcy system as a whole.[1] There are currently approximately 1,200 bankruptcy trustees receiving new cases, of whom nearly 1000 are NABT members.

A fundamental duty of bankruptcy trustees is to maximize the assets available for distribution to a bankrupt debtor's creditors. One of the most powerful tools given by Congress to trustees (or other estate representatives) to achieve that objective is the power to avoid and recover certain pre-bankruptcy transfers by a debtor, including those that place assets outside the reach of its creditors or that have the effect of preferring one creditor over another.

This appeal addresses an enormously important application of that power. For over a hundred years, creditors have been able to avoid transfers made by a debtor without receiving fair consideration when the transfer leaves the debtor unable to pay those creditors, whether or not there was any intent to defraud them. A debtor must be just before she is generous. A trustee's ability to recover a constructively fraudulent transfer is often the creditors' only hope for

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[1] Undersigned counsel for NABT authored this brief in its entirety; no other person or entity has made any monetary contribution to the preparation or submission of this brief. Consent of all parties to the submission of amicus curiae briefs has been lodged with the Clerk of the Court.

a meaningful recovery, and the Court's decision will have a dramatic effect on the ability of *Amicus'* members to achieve that central objective of the Bankruptcy Code.

SUMMARY OF ARGUMENT

Under Petitioner's construction of section 546(e) of the Bankruptcy Code, 11 U.S.C. § 546(e), a trustee may not exercise the Code's power to avoid injudicious transfers by an insolvent debtor when the transfer to be avoided involves a security, no matter the disparity between value and consideration, because every such transfer invariably involves a financial institution. The exception would apply whether the sale involves stock in a family-owned company or publicly-traded corporation, and whether the parties are neighbors or hedge funds, so long as they use a bank.

The ability to avoid constructively fraudulent transfers is a century-old, indispensable tool for restoring funds to a depleted bankruptcy estate. It is often the sole effective remedy available to a trustee. The transfer from Valley View to Merit Management in this case is exactly the type of constructively fraudulent transfer that Congress gave trustees the power to avoid in Chapter 5 of the Code. Neither the text nor the statutory context of § 546(e) support the conclusion that it was intended to eliminate that right anytime the transfer involves a sale of stock. Its legislative history, in tandem with the most basic canons of statutory interpretation, demonstrates that Merit's application of the statute is not what Congress intended.

Importantly, Merit's § 546(e) exclusion would prevent a trustee from attempting to unwind a failed leveraged buyout, even when it is a purely private transaction, as most are. Encumbering a company's assets to finance its own acquisition poses a unique hazard to unsecured creditors. Leverage greases the wheels of such transactions, enabling buyers to offer a hefty premium to controlling shareholders while minimizing their own capital costs and greatly increasing their potential investment return. The company skates on a thin margin until the contemplated disposition event. Unsecured creditors are left to bear the risk that the company will sink under the weight of its new debt load, as some inevitably do.

When controlling shareholders are cashed out by pushing the company into insolvency, the Bankruptcy Code permits a trustee to avoid and recover those transfers. Nothing in the legislative history of § 546(e) suggests that Congress intended to insulate the ultimate recipients of such transfers from liability so long as they use a bank rather than gold bar or a briefcase full of cash. Congress' concern was the integrity of the public securities clearance system, not shareholders' investment expectations and calculations. The plain language of § 546(e), its statutory context and its purpose all support the Seventh Circuit's sensible construction. Its decision should be affirmed.

ARGUMENT

I. Section 546(e) Does Not Bar Avoidance of the Transfer From Valley View to Merit

A. Congress Intended Trustees to Have the Power to Avoid Precisely This Type of Constructively Fraudulent Transfer

1. "A bankruptcy trustee is tasked with maximizing the recovery of unsecured creditors." *State Bank v. Covey (In re Duckworth)*, 776 F.3d 453, 458 (7th Cir. 2014). To that end, Congress armed the trustee with the power to avoid and recover for the benefit of creditors certain types of transfers made by a debtor before the bankruptcy case commenced. The trustee's avoidance power "prevents the depletion of the estate, promotes an equitable distribution of the debtor's assets, and protects creditors who advanced credit in ignorance of fraud." *Dzikowski v. N. Trust Bank of Fla., N.A. (In re Prudential of Fla. Leasing Inc.)*, 478 F.3d 1291, 1299 (11th Cir. 2007).

Those powers, contained in Chapter 5 of the Bankruptcy Code, include the right under section 547 to avoid transfers that result in the preference of one creditor over another, the right under section 548 to avoid fraudulent transfers of a debtor's property, and the trustee's so-called "strong arm" power under section 544, which gives a trustee the rights of a hypothetical lien creditor or good-faith purchaser as of the petition date. 11 U.S.C. §§ 544, 547 & 548. A fundamental goal of a trustee's avoiding powers is to "'facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (quoting H.R.

Rep. No. 95-595 at 177-78 (1977)). Put differently, "Congress determined that a few individuals should not be allowed to benefit from transfers by an insolvent entity at the expense of the many." *Jewel Recovery, L.P. v. Gordon (In re Zale Corp.)*, 196 B.R. 348, 352 (N.D. Tex. 1996).

2. Perhaps the most important of these powers from the standpoint of equity and compensation of creditors is the right to avoid and recover prepetition transfers made by an insolvent debtor without receiving fair consideration, to the prejudice of its creditors. It is "longstanding bankruptcy policy—inherited by this nation at its founding and dating back to England's Statute of Elizabeth, enacted in 1571—that insolvent debtors should not be able to evade their financial commitments by making gifts."[2] This statute provided that a conveyance made "to the End, Purpose and Intent to delay, hinder or defraud creditors" is voidable. 13 Eliz., ch. 5 (1571). "Every American bankruptcy law has incorporated a fraudulent transfer provision; the 1898 Act specifically adopted the language of the Statute of Elizabeth." *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 540 (1994); *see* Bankruptcy Act of July 1, 1898, ch. 541, § 67(e), 30 Stat. 564-565 (adopting statutory language).

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[2] *Bankruptcy Issues in Review: The Bankruptcy Code's Effect on Religious Freedom and a Review of the Need for Additional Bankruptcy Judgeships Before the Subcomm. on Admin. Oversight and the Courts and the Comm. on the Judiciary*, 105th Cong. 1 (1997) (prepared statement of Donald S. Bernstein on behalf of the National Bankruptcy Commission).

A transfer made for inadequate consideration by an insolvent debtor was among the "badges of fraud" raising a rebuttable presumption of fraudulent intent. "A vendee who purchases the property of an insolvent debtor for less than its value thereby deprives the creditors of the difference, and defeats their just expectations." Orlando F. Bump, Fraudulent Conveyances, *Fraudulent Conveyances: A Treatise Upon Conveyances Made by Debtors to Defraud Creditors* 86 (1872). From this evolved the concept of "constructive fraud," in recognition of the fact that creditors suffer harm when a debtor transfers property for less than fair consideration, even without actual fraudulent intent, at a time when the debtor is insolvent or when the debtor becomes insolvent due to the transfer. This concept was incorporated in the Uniform Fraudulent Conveyance Act, drafted in 1918, and absorbed into federal bankruptcy law in 1938 through provisions of the Chandler Act. *See generally BFP*, 511 U.S. at 540-41; 5-548 *Collier on Bankruptcy* ¶ 548.01 (16th ed. 2017).

Section 548(a)(1)(B) of the Code carries forward this important creditor remedy. A trustee may avoid a transfer by the debtor of an interest in property for less than "reasonably equivalent value," made while the debtor was insolvent or that rendered the debtor insolvent, or that left the debtor with "unreasonably small capital" to engage in a business or transaction, or unable to pay contemplated debts as they came due. Section 546 limits the trustee's ability to avoid such constructively fraudulent transfers. Relevant here, a trustee "may not avoid" a "transfer" that is a "settlement payment ... made by or to (or for the

benefit of)" a financial institution or other enumerated entity. 11 U.S.C. § 546(e).

3. To a bankruptcy trustee charged with maximizing the value of the estate, the successful administration of Valley View's bankruptcy case turns on the prosecution of what is or should be a garden variety lawsuit to avoid a constructively fraudulent transfer. Assuming the truth of the allegations, Valley View settled a dispute by paying a competitor $55 million to withdraw from bidding for an asset that later sold for $5.6 million. It is a paradigmatic constructive fraudulent transfer: whatever the cause of the disparity, it was a transfer by an insolvent debtor for which it received far less than reasonably equivalent value, no less harmful to creditors than purchasing oceanfront property in the Solomon Islands for $50 million, or any similar miscalculation or folly. The transferor's insolvency is the nub, not its financial acumen. The trustee sued Merit for its $16.5 million share and the payment of Valley View's creditors depends on its recovery. The structure of the transaction as a private sale of stock in Bedford Downs and the use of leverage appear to have been virtually incidental to its purpose, but because the parties used a bank to complete the transfer from Valley View to Merit, the stock sale is an incident that the Court is urged to hold was intended by Congress to prevent the trustee from avoiding the transfer.

B. The Statutory Text and Context Do Not Support Merit's Overexpansive Construction of Section 546(e)

The argument that § 546(e) precludes avoidance in a case such as this strikes at the heart of a trustee's mission and ability to maximize and ratably distribute the estate of a bankrupt business. It is terrible public policy but, more importantly, the argument is not supported by the text or context of the statute and is not a policy that Congress expressed an intention to promulgate. Congress acted to protect the stability of the securities-clearance system by insulating its constituents from avoidance liability. If it is also good policy to inspire investor confidence by instituting a per se rule that no sale of stock is subject to avoidance no matter how unbalanced, so long as it was not intended to defraud creditors, then Congress should pass such a law. It has not yet done so. If such a measure passes, it will surely preserve a trustee's ability to avoid for the benefit of innocent creditors transfers such as this, as well as the smorgasbord of contrived securitized transactions that will follow if § 546(e) sweeps as broadly as Merit argues it should.[3]

1. As *amicus curiae*, we will not exposit at length on what we believe are the compelling textual and contextual arguments articulated by the Seventh Circuit and the Respondent. We agree entirely with the holding that § 546(e)'s exclusion from avoidance of "a transfer made by or to (or for the benefit of)" specified intermediaries in the securities-clearance

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[3] The type of asset sale that could be securitized in some fashion is limited only by the imagination.

system "in connection with a securities contract," refers, as a matter of plain English and in the context of Chapter 5 of the Bankruptcy Code, to the transfer that the trustee seeks to avoid, of the debtor's property to its ultimate recipient and not to its wire transfer agent. 11 U.S.C. § 546(e).

2. The word "transfer" weaves its way through Chapter 5 with apparent uniformity, from its substantive provisions for the avoidance of transfers under sections 544(a), 545, 547(b), 548 and 549, through its limitations on the avoidance of such transfers in § 546 and its provisions for (and limitations on) the recovery of avoided transfers in § 550. "[I]dentical words used in different parts of the same statute are generally presumed to have the same meaning . . . ." *IBP, Inc. v. Alvarez*, 546 U.S. 21, 34 (2005). And, in fact, the word "transfer" does have a uniform meaning within all of those provisions when it is used to refer to an avoidable transfer by a debtor to a transferee or for the benefit of a nontransferee. So used, each of the provisions in which it appears works, internally and in concert with the others, including § 546(e); it is the "fundamental transactional unit in the Code's avoiding-power provisions." Ralph Brubaker, *Understanding the Scope of the § 546(e) Securities Safe Harbor Through the Concept of the "Transfer" Sought to Be Avoided*, 37 Bankr. L. Letter, July 2017, at 9.

3. So used, as well, § 546(e) rests comfortably in Chapter 5 rather than presenting as a misplaced provision of the Securities Exchange Act intended to encourage the formation and investment of capital by assuring shareholders not just that their trades will

settle without disruption, but that their individual investment decisions will not be subject to scrutiny under bankruptcy laws. Courts must interpret a statute "as a symmetrical and coherent regulatory scheme," *Gustafson v Alloyd Co.*, 513 U.S. 561, 569 (1995), and "fit, if possible, all parts into an harmonious whole." *FTC v. Mandel Bros. Inc.*, 359 U.S. 385, 389 (1959). *Amicus* concurs that "Chapter 5 creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin. It makes sense to understand the safe harbor as applying to the transfers that are eligible for avoidance in the first place." *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690, 694 (7th Cir. 2016).

C. The Interplay Between Sections 546(e) and 550 Demonstrates That Merit's Analytical Construct Runs Counter to Congressional Intent

Conversely, using the word "transfer" noncontextually and, in particular, to refer to whatever alienation of property a defendant chooses to identify rather than the putative avoidable transfer identified by the trustee, would make mincemeat of § 550. Moreover, as discussed below, the law that leads Merit out of its § 550 mess is exactly the law that demonstrates unequivocally why its slice-and-dice analysis is not what Congress intended when it enacted § 546(e).

1. Section 550 is integral to a trustee's exercise of the Bankruptcy Code's avoidance powers. It is the "recover" of "avoid and recover." The trustee can recover the property transferred or its value from the

"initial transferee of such transfer," § 550(a)(1), or from "any immediate or mediate transferee of such initial transferee," § 550(a)(2). To the latter, it provides a defense: a trustee may not avoid a transfer under § 550(a)(2) from a transferee that takes for value and in good faith and who did not know of the voidability of the transfer, and "any immediate or mediate good faith transferee of such transferee." 11 U.S.C. § 550(b).

Here, Merit insists for purposes of § 546(e) that there was no $16.5 million avoidable transfer from Valley View to Merit, but only three intermediate nonavoidable "transfers" to and by financial intermediaries (Pet. Br. at 2). Carrying that approach over into § 550 would mean that Merit was not the initial transferee of a $16.5 million transfer from Valley View under § 550(a)(1) or even the immediate transferee of such transferee under § 550(a)(2). Merit would be a mediate transferee thrice removed from the initial transferee. If the Code's terminology is to be applied uniformly, then under Merit's construct, even if § 546(e) did not apply, the money could not be recovered from Merit if any one of its predecessor transferees was a good-faith transferee. Obviously, if transfers can be diced thusly, it would be a rare avoidable transfer that could be recovered under § 550.

2. There is a meaningful nexus between the foregoing dilemma and Merit's flawed interpretation of § 546(e). The background law that prevents this result is the very law that gave rise to § 546(e). As discussed by the Respondent (Res. Br. at 37), the law in all circuits is settled that a transferee is an entity with "dominion over the money" or "the right to put the money to one's own purposes" and not an intermediary

or conduit. *See, e.g., Bonded Fin. Serv., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988). This principle is the genesis of § 546(e), which was enacted in 1976 in response to a district court's failure to rule on summary judgment that a clearing association received payments from a bankrupt commodity broker as a "conduit" and not as a "transferee." *Seligson v.New York Produce Exch.*, 394 F. Supp. 125 (S.D.N.Y. 1975). The *Seligson* court found that the trustee had "raised a genuine issue as to whether [the debtor] owed its obligation directly to the credit members, and this issue is material to the question of whether the Association acted as an agent for net credit members." *Id.* at 136. Congress abrogated the decision by providing that "the trustee may not avoid a transfer that is a margin payment to or deposit with a commodity broker or forward contract merchant or is a settlement payment made by a clearing organization." Pub. L. No. 95-598, 92 Stat. 2549 (1978), *codified at* 11 U.S.C. § 746(c) (repealed 1982); *see* S. Rep. No. 95-989, at 105 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5891.

3. But Merit puts § 546(e) to a very different use than Congress intended. The statute provided "belt and suspenders" protection to the clearinghouse. Inasmuch as Merit treats § 546 and § 550 as if they bore no relation to each other (in order to avoid the absurd result discussed above), it would be the first to admit that § 546(e) was not intended to displace the principle that transfers to intermediaries are not avoidable. Nor is there evidence that Congress intended to preclude the *Seligson* trustee from suing those for whom the trustee claimed the clearinghouse was acting as agent, in order to avoid the same debtor-

to-ultimate-recipient transfer that is at issue in this case.

Thus, Merit inverts the intended operation of § 546(e). If the law does not recognize any transfer from Valley View to Merit, as Merit contends, then, necessarily, each of the intermediate transactions constitutes a transfer that is subject to avoidance, or would be but for the protection of § 546(e). But Congress intended § 546(e) to supplement, not replace, the law on transfers to conduits or intermediaries. Merit's convenient interpretation of § 546(e) is inconsistent with that intent.

II. This Case Should Not Be Decided on the Basis of its Implications for Failed Leveraged Buyouts of Large Public Corporations

Amicus wishes also to address the view of the Tribune *amici* that the Court should decide this matter with both eyes focused on its implications for fraudulent transfer cases involving failed leveraged buyouts of large public corporations, such as the recent Tribune and Lyondell bankruptcy cases. A trustee's ability to avoid failed leveraged buyouts as constructively fraudulent to creditors, in appropriate circumstances, is tremendously important as a matter of bankruptcy policy. The § 546(e) exception achieves its intended purpose of ensuring the stability of the securities-clearance system. While individual shareholder recipients of LBO largesse may have concerns that a trustee may pursue their gains from the sale of stock at a premium so steep that it does not constitute fair consideration (however unlikely that may be), there is no evidence other than their own expansive interpretation of the text of § 546(e) that

Congress intended them to be its beneficiaries. Certainly, the application of § 546(e) is unwarranted in the context of the private transactions in which the issue nearly always arises.

A. Leveraged Buyouts Have Exactly the Type of Pernicious Effect on Unsecured Creditors That the Bankruptcy Code Was Intended to Address

1. Many of the most important purposes of our bankruptcy laws converge when a company descends into bankruptcy following a leveraged buyout. Without fail, the principal victims are unsecured creditors, which may include not just trade creditors but bondholders such as employee pension plans, retirement plans, mutual funds, and other entities that manage funds belonging to millions of individuals. The immediate beneficiaries are the shareholders, that is to say, former controlling shareholders who commanded a large premium made possible by borrowings against corporate assets, creating a debt load the company could not carry. To be sure, unsecured creditors are not the only stakeholders to lose. But they are among the only who did not make a calculated gamble on a new capital structure. They had no say when the target company's operating needs were balanced against the buyer's desire to maximize its investment return through leverage.

In such cases, the trustee's avoidance power vindicates not only the policies of maximizing the estate and equality of treatment among creditors, but also the traditional priority of creditors over shareholders, commonly expressed as the absolute

priority rule.[4] "The Code's priority system constitutes a basic underpinning of business bankruptcy law." *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 983 (2016); *see also Northern Pac. R. Co. v. Boyd*, 228 U.S. 482, 504 (1913) ("Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor, was invalid."). Though it occurs prior to bankruptcy, a transaction in which a company effectively cashes out its controlling shareholders at the expense of its solvency is for all practical purposes a device that prefers stockholders over creditors, analogous to the insider machinations the absolute priority rule is intended to counter. *See Bank of America Nat. Trust & Sav. Assn. v. 203 North LaSalle Street P'ship*, 526 U.S. 434, 444 (1999) (discussing how the absolute priority rule was developed in response to "concern with 'the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage'" (quoting Report of the Comm'n on the Bankruptcy Laws of the United States, H. R. Doc. No. 93–137, pt. I, at 255 (1973))).

2. Most leveraged buyouts are private transactions. Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. Econ. Perspectives 121, 127-28 (2009) (Between 1995 and 2004, leveraged buyouts of private companies accounted for over 90% of transactions and 80% of transaction value, declining as a percentage of transaction value to 66% during the

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[4] *See* 11 U.S.C. § 1129(b)(2) (requiring for confirmation of a plan of reorganization, absent consent, that creditors and equity interest holders be paid in order of priority).

following 3 years). What gives this public policy issue such significance is their exponential growth, the risks they pose to unsecured creditors, and the lack of other effective remedies when they fail other than the trustee's avoidance powers. While there were only 103 leveraged buyouts from 1970 through 1984, from 2005 through 2007 alone there were 5,188 leveraged buyouts representing a combined estimated enterprise value of over $1.5 trillion. *Id.* at 126-27. While we have been unable to obtain updated statistics for what, from an avoidance perspective, would represent the current "generation" of leveraged buyouts, interest rates remain low, and "[w]hen credit is cheap and the economy is growing, highly leveraged buyouts represent the optimal means by which private equity firms acquire target companies." Samir D. Parikh, *Saving Fraudulent Transfer Law*, 86 Am. Bankr. L.J. 305, 307 (2012).

3. By nature, these transactions expose unsecured creditors to risk. The form varies greatly but the net effect is the same: A company with a healthy balance sheet and liquidity incurs substantial debt and grants liens on its assets to finance the purchase of itself. The acquisition is financed with 60-90% debt. Kaplan at 124. The target company will necessarily have significant equity that can be replaced by the financing debt and ample cash flow available for the increased debt service. *See* Peter A. Hunt, *Structuring Mergers & Acquisitions 101*, 293 (4th ed. 2009). As a result, the company's debt ratio increases *on average* from 38% to

70%.[5] The replacement debt is lower-grade, *see* Hunt at 300-03, and the buyer's investment horizon is often fairly short: 42% exit within five years of the buyout. Kaplan at 127. The magic of leverage reduces capital risk to the buyer and greatly increases its potential return on investment, while generating tax savings from the deduction of interest. The promise of a substantial return generates a large premium for selling shareholders; private equity typically pays public shareholders a 15-50% premium over the current stock price. Kaplan at 124. Unsecured creditors gain no benefit from the increased risk of insolvency, however, and once in bankruptcy, the company's assets are usually fully encumbered by the liens securing the debt that financed the acquisition. *See generally* John H. Ginsberg et al., *Befuddlement Betwixt Two Fulcrums: Calibrating the Scales of Justice to Ascertain Fraudulent Transfers in Leveraged Buyouts*, 19 Am. Bankr. Inst. L. Rev. 71, 74-75 (2011).

The Third Circuit captured the problem twenty-five years ago: "The problem universal to all LBOs—characterized by their high debt relative to equity interest—is that they are less able to weather temporary financial storms because debt demands are less flexible than equity interest." *Mellon Bank, N.A. v. Metro Commc'ns*, 945 F.2d 635, 647 (3d Cir. 1991).

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[5] *See* Ulf Axelson, Tim Jenkinson, Per Stromberg & Michael Weisbach, Borrow Cheap, Buy High? The Determinants of Leverage and Pricing in Buyouts 32 (Nat'l Bureau of Econ. Research, Working Paper No. 15952, 2010), available at http://www.nber.org/papers/w15952, at 47 tbl. 5 (finding, in broad sample of LBOs, ratio of debt to enterprise value increased from average of 0.38 pre-LBO to average of 0.70 post-LBO).

One need look no further than Tribune Company for a recent example. After the company incurred nearly $9 billion in new debt to finance its own acquisition, it was left in the position that it would be insolvent if its financial projections were off by even two percent. *See* Report of Kenneth N. Klee, As Examiner, *In re Tribune Co.*, No. 08-13141, Vol. 1 at 170-78, 205-10, 460-62 (Bankr. D. Del. Aug. 3, 2010) [hereinafter "Klee Report"]; Complaint at 26, *Official Comm. v. Fitzsimons (In re Tribune Co.)*, No. 10-54010 (Bankr. D. Del. Nov. 1, 2010). When a financial analytics firm balked at issuing a solvency opinion, it was replaced by one that would. The company fell into bankruptcy in less than a year. *See generally* Ginsberg at 73.

4. Because the transaction is structured around secured debt, the trustee's avoidance powers usually represent unsecured creditors' best or only hope for a meaningful recovery. As the Tribune examiner explained, because the LBO financing "occupies a structurally senior position, if this indebtedness is not avoided, subordinated, or disallowed, the holders of those claims would recover most of the value available from the Debtors' bankruptcy estates. . . . Thus, among the above-listed potential avoidances and recoveries underlying Question One, the actions to avoid the LBO Lender Debt are the proverbial "main event."" Klee Report, Vol. 2 at 10.

B. There is No Evidence That Congress Intended Section 546(e) to Advance the Behavioral Economics Policies Postulated by *Amici*

Congress enacted § 546(e) "to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market," H.R. Rep. No. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583. The merits of the behavioral economics principles expounded by *Amici*—promoting capital formation and liquidity by instilling investor confidence that their investment decisions can never be challenged—are debatable as a matter of economic and bankruptcy policy. Regardless, the timeline and legislative history of § 546(e) do not support the conclusion that Congress had any goal more ambitious than maintaining the stability of the securities clearance and settlement system. Indeed, the evidence is so sparse that the degree of certainty expressed by some is puzzling. Most such litigation involves private transactions but if greater investor protections are needed, Congress will act. Section 546(e) was not such an act.

1. The only kind of avoidance litigation that could implicate the broad policies discussed by the Tribune *amici* would be avoidance litigation concerning the failed leveraged buyout of a large public company. Between 1970 and 1984, however, leveraged buyouts were rare: only 103 were announced from 1970 through 1984. Kaplan at 127 tbl.1. At the time of the 1981 Subcommittee Hearings, leveraged buyouts remained an anomaly, and there is no mention of leveraged buyouts or the potential fraudulent transfer

implications of stock transfers in the 500 pages of testimony during the 1981 Subcommittee Hearings. Parikh at 337-38.

2. The purpose of the 1982 amendment was simply to add the same protections for the securities markets as the commodities markets. As stated in the House Report:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature the markets [*sic*], *certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.*
>
> The Bankruptcy Code now expressly provides certain protections to the commodities market *to protect against such a "ripple effect."* One of the market protections presently contained in the Bankruptcy Code, for example, prevents a trustee in bankruptcy from avoiding or setting aside, as a preferential transfer, margin payments made to a commodity broker (see *11 U.S.C. Sec. 764(c)*).
>
> The thrust of several of the amendments contained in H.R. 4935 is to clarify and, in some instances, broaden the commodities market protections and *expressly extend similar protections to the securities market.*

H.R. Rep. No. 97-420 at 1-2 (emphasis added).

By 2005, of course, a substantial body of law had developed concerning the application of § 546(e) in actions to avoid leveraged buyouts—on both sides of the issues—yet the House Report accompanying the 2005 amendment (which added "financial participants" to the list of protected entities) reflected no change in legislative intent, reiterating that § 546(e) was "designed to reduce systemic risk in the financial market place." H.R. Rep. No. 109-31(I), at 3 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89. Had Congress intended to expand the application of § 546(e) beyond its original purpose, or even to clarify its application in the face of frequent judicial resistance to the Tribune *amici's* position, it would presumably have said so. As this Court famously said, "Congress ... does not ... hide elephants in mouseholes." *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 457, 468 (2001).

3. Section 546(e) was enacted to counteract a particular kind of risk. It achieves that purpose. In the clearance-and-settlement system, parties "use intermediaries to make trades of [securities] which are instantaneously credited, but in which the actual exchange of [securities] and consideration therefor takes place at a later date." *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 675 (D.R.I. 1998). In this system, the intermediaries' role is "critical" because of the lapse of time in between the date of a trade (when the intermediary credits and debits the counterparties' accounts) and the date of settlement (when the securities and consideration are actually exchanged). *Id.* at 676. The system "depends upon a series of guarantees, made by all parties in the chain," including the intermediary, "that they will live up to their obligations regardless of a default by another party in

the chain." *Id.* If the "pre-bankruptcy trades by a bankrupt intermediary could be set aside" through avoidance, then "the guarantees that allow the system to function would be threatened," and "a bankruptcy by one party in the chain could spread to other parties in the chain, threatening a collapse of the entire industry." *Id.*

As Judge Gerber recognized in *Lyondell*, actions directed at "LBO payments [made] to stockholders at the very end of the asset transfer chain, where the stockholders are the ultimate beneficiaries of the constructively fraudulent transfers, and can give the money back to injured creditors with no damage to anyone but themselves" "would not create systemic risk." *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348, 372-73 (Bankr. S.D.N.Y. 2014).

4. There is simply no evidence other than Merit's and *amici's* own expansive reading of the text that congressional intent in enacting and amending § 546(e) was to promote capital formation and prevent avoidance actions from eroding investor confidence and discouraging public investment (Tribune Am. Br. at 27) or to prevent trustees from "unwinding long-settled, complicated transactions and creating arbitrary distinctions among market participants." *Id.* at 30. Courts "do not sit to assess the relative merits of different approaches to various bankruptcy problems." *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 13-14 (2000). Congress circumscribed the avoidance powers of bankruptcy trustees so that a bankruptcy would not generate litigation against market intermediaries. Congress did not foreclose avoidance action against every market participant, or

abandon the Code's fundamental goal of maximizing creditor recoveries.

CONCLUSION

Amicus submits that the decision of the Seventh Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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